e. **Balloting and Allocation.**

(i) Over time, residential and commercial retail customers of NetCo would migrate to ServeCo or to its CLEC competitors. When the relevant state commission determines that wholesale OSS systems to provision and support network element combinations are capable of processing the same volumes of customer transfers, in the same intervals as the PIC-change systems used to process long distance customer transfers then a state commission would be free to order balloting to remove the remaining retail customers from NetCo. 28/ At that point, NetCo would be a pure "carrier's-carrier."

(ii) Any non-balloted customers would be allocated among ServeCo and its CLEC competitors on a competitively neutral basis. Allocation procedures would need to be approved by the state commissions

f. **Regulation of the Companies.**

(i) All NetCo offerings purchased by ServeCo would be via tariff (or some other generally available mechanism), with prices established by the state commissions subject to the requirements of Section 252(d). The interconnection agreements between NetCo and CLECs would continue in force, with general nondiscrimination requirements applying.

(ii) ServeCo's retail services would be regulated on the same basis as the those of its CLEC competitors. As a general rule, bundling of all retail services would be allowed and rates for all retail services and service packages would be subject to limited or no regulation. If deemed necessary after NetCo exits the retail market following balloting/allocation, state commissions could require all retail

28/ This would provide the public time to become familiar with the presence of local competitors.

companies to offer a "basic" no-frills local exchange service offering at an affordable rate as a precondition to universal service support.

(iii) Access rates of ServeCo would be regulated no differently than the access rates of its CLEC competitors (for example, they could be subject to a cap on terminating access rates, if one applied to other CLECs).

(iv) NetCo could offer access only in connection with its embedded customer base. Exchange access rates of NetCo would be regulated the same way they are today, under the interstate price cap rules and whatever state regulation applies to intrastate access.

(v) NetCo would be regulated as the incumbent ILEC, including pursuant to Sections 251 and 252.

(vi) NetCo could not provide non-cost-based discounts volume or other types) to ServeCo or any other carrier.

g. Universal Service Support.

(i) ServeCo would be eligible for universal service funding in connection with its purchase of network elements to the same extent as any other retail service provider.

(ii) NetCo would receive universal service funding to the extent it continues to serve retail local exchange customers.

(iii) After balloting and allocation, as before, state commissions would ensure that the network element rates are cost-based and therefore sufficient to ensure NetCo's financial integrity.

(iv) States remain free to adopt other non-discriminatory measures to protect universal service.

h. Sunset.

(i) The ServeCo/NetCo structure would remain in place once implemented.

(ii) HoldCo could not opt out of the plan after entering the interLATA market through ServeCo.

(iii) At the point when CLECs no longer are dependent on the RBOC wireline network because competitive alternative local exchange networks have developed, 29/ the FCC and state commissions may revise their policies and rules in ways that would permit NetCo and ServeCo to merge, or permit NetCo to enter the retail market by other means, including a transaction with a retail service provider other than ServeCo.

B. Steps to Be Taken by the FCC.

The Commission can clear the path to this "Fast Track" Section 271 option through a few, relatively simple declaratory rulings. They are as follows:

(i) Section 271. The FCC would declare that, if an RBOC creates a ServeCo satisfying the key elements of separation and independence set forth here, the RBOC will receive a rebuttable presumption that it has met the competitive checklist and public interest test of Section 271. 30/ This presumption is justified because the change in the RBOC's incentive structure and separation that would result from the creation of ServeCo sufficiently improves prospects for parity and

29/ The FCC and state commissions would have to determine that actual, market-disciplining facilities competition exists throughout the RBOC's region.

30/ The RBOC also must actually be providing or generally offering each checklist item in order to meet Section 271. 47 U.S.C. § 271(c)(2)(B). We recognize that under this proposal, the ultimate burden of proof still rests with the RBOC. *See Application of Bell South Corp. Pursuant to Section 271*, CC Docket No. 97-208, FCC 97-418 (rel. Dec. 24, 1998) at para. 37. However, the rebuttable presumption should substantially expedite the process by which an RBOC meets that burden.

nondiscrimination in the provision of wholesale inputs by NetCo, crucial elements of the Act's interLATA preconditions. 31/

(ii) Section 251(h). The FCC would declare that, when an RBOC elects to operate on this partially separated basis, ServeCo will not be considered a "successor or assign" or ILEC "replacement" for purposes of Section 251(h), and therefore will not be subject to those Section 251(c) obligations. This conclusion is justified because the independence of a ServeCo constituted as described herein, and the continuing obligations of NetCo, together reduce the concerns embodied in Section 251(h) that an RBOC might sidestep its duties under the Act through new corporate affiliates.

(iii) ServeCo Regulation. The FCC would declare that a properly constituted ServeCo will be considered a non-dominant carrier for all purposes, and therefore subject to the same regulation as other CLECs. This ruling would allow ServeCo to bundle packages of local and long distance, and provide exchange access, on a non-dominant basis, as well as be excused from other regulation. This conclusion is appropriate because the incentives and ability of NetCo to discriminate in favor of ServeCo are reduced by the structural changes the FCC would require in its rulings.

Importantly, we are not asking the Commission to *require* any RBOC to make the corporate structure changes needed to qualify under this "fast track" approach. Instead, we are suggesting that the FCC make this "fast track" approach *available* for any RBOC wishing to so qualify. 32/

31/ The RBOCs still would need to meet the prerequisites of Section 271(c)(1)(A) or (B) (the "Track A" or "Track B" tests).

32/ Furthermore, we are asking that the FCC establish this alternative to be available in any instance where a state commission orders this structure to achieve its own regulatory objectives.

As importantly, LCI is not suggesting any alteration to the statutorily imposed Section 271 burden on the RBOCs, nor any lowering of standards or elimination of any competitive checklist item under Section 271. At the same time, however, qualification under Section 271 would be attainable much faster by an RBOC under this structure, and would be far easier for the Commission to determine and verify. For example, the competitive checklist provisions of Section 271 are designed to ensure that an RBOC makes available to retail competitors the tools necessary to provide local service, and in particular does so on a non-discriminatory basis. An RBOC retains an incentive to discriminate in favor of any affiliate. Nevertheless, if the RBOC is prepared to use exactly the same tools as CLECs, through an independent subsidiary, to provide its own retail local services, then it is more reasonable to presume that the checklist items will be provided on an effective and nondiscriminatory basis. Similarly, it is more reasonable to presume that in these circumstances, RBOC entry into the interLATA market now would be in the public interest.

This plan also is consistent with other sections of the Act, even as it permits substantially reduced regulation. For example, the obligations of Section 251(c) will continue, but enforcement will be simplified and focused on NetCo. Similarly, because discrimination concerns are reduced, the Commission and the states can adjust their regulatory policies accordingly for the post-entry period. Sections 201 and 202 will continue to apply to ServeCo's rates, but ServeCo's offerings will be presumed to comply with those sections (as are CLECs' offerings).

Properly understood, the proposal comports with what the Commission already has done in its *Non-Accounting Safeguards Order* under Section 272. Specifically, in that *Order* the Commission set out various rights and obligations of an RBOC affiliate under Section 272. 33/ The proposal here is fully consistent with those rights and obligations. Thus, the proposal simply says: If the RBOC is willing to go a step further in a manner that fundamentally alters its

33/ *Non-Accounting Safeguards Order*, 11 FCC Rcd at 21913-15, 22054-58, paras. 14-19, 309-16.

incentives, then it will obtain additional benefits, which benefits ultimately would inure to consumers as well.

C. Steps to Be Taken by the States.

The states also have a central role to play in making the proposal a reality, while addressing their own unique competitive and universal service goals. This petition, together with the related state petitions to be filed with this petition, address the states' role in this regard.

D. Timing of Implementation of the Proposal.

If the Commission moves with expedition, LCI believes it would be feasible to adopt the necessary rulings by approximately June 30, 1998. State commissions could undertake similar proceedings under roughly the same schedule. Once approved, the RBOC-ServeCo affiliate could be implemented and prepared for unregulated retail competition within an additional four-to-six months after that. Hence, this proposal could produce open, unrestricted retail competition by the end of 1998 or soon thereafter.

III. THE PROPOSAL HELPS TO RESOLVE THE MAJOR BARRIERS TO LOCAL COMPETITION.

A. "Fast Track" Contains the "Seven Minimums" Needed to Address RBOC Conflicts of Interests.

LCI recognizes that, over time, various other parties have suggested separation of the RBOC's wholesale and retail operations -- to a greater or lesser degree -- as a means to resolve the conflicts of interest between them. 34/ More recently, as disputes over implementation of

34/ *See, e.g.*, Jerry Duvall, *"The Evolution of Competition in the Market for Local Telecommunications Services: A Proposal for Industry Organization in the 21st Century,"* at 9, presented before the conference of the United States Telephone Association on "Survival Strategies for the Future: Planning for Change and Consolidation" (June 29, 1987)(proposing that LECs evolve toward an organizational structure where local exchange network facilities are operated in a corporate entity that remains subject to public utility regulation, and all retail local exchange services are provided over those facilities "by multiple, competing local 'Telecommunications Service Companies' that are completely unregulated.")

Section 251 have grown, one party has suggested that a new divestiture is necessary. Under this plan the RBOCs would be required to spin off their local network facilities to a wholly new company in which they have no financial interest at all. 35/

At the same time ILECs themselves, including the RBOCs, are recognizing the advantages of establishing separate retailing "CLEC" affiliates in which they hope to offer local and other services on an unregulated basis -- free from Section 251(c) obligations and retail rate regulation, for example. As noted above, these ILEC-designed plans typically contain serious competitive weaknesses that do not solve the conflict of interest problem underlying the current stalemate (and in fact, may make it worse). 36/

LCI is interested in breaking the current stalemate quickly so that it can realistically offer local service, especially to its residential customers. LCI's "Fast Track" proposal will not solve all regulatory issues. Nevertheless, we believe that this structure can advance consumer interests because it contains the seven minimum elements necessary to reduce RBOC conflicts of interest. We emphasize that the "seven minimums" are entirely indivisible; if one is missing the others are not effective. We further emphasize that "Fast Track" in no way interferes with the traditional jurisdiction of the states to take whatever additional steps they may deem necessary to enhance separation, prevent anti-competitive discrimination, and protect their consumers.

35/ *See, e.g.*, Letter to Reed E. Hundt, Chairman, FCC, from Roy L. Morris, US ONE, Aug. 11, 1997, filed in *Recommendations for Commission Actions Critical to the Promotion of Efficient Local Exchange Competition*, CCB Pol. 97-9, and *Implementation of the Local Competition Provisions of the Telecommunications Act of 1966*, CC Docket No. 96-98. Mr. Morris expands upon the LoopCo Plan in *A Proposal to Promote Telephone Competition: The LoopCo Plan*, CCH Power and Telecom Law, Vol.1, No.2 at 35 (January/February 1998).

36/ In recognition of these problems, the Texas Commission denied GTE's request for CLEC authority in its own service area, and the Florida Commission is holding hearings on BellSouth's CLEC application. *See GTE CLEC Certification Order, supra.; FL BellSouth CLEC Certification (Jan. 14, 1998 Order Establishing Procedure), supra.*

The "Seven Minimums" of Fast Track

1. **NetCo and ServeCo would not share facilities, functions, services, employees or brand names.** NetCo and ServeCo would be completely separate physically, operationally and functionally, and they would not share the same brand or trade name. Any sharing of resources would undercut the separation of corporate identities and strategic goals that is the foundation of this plan. It would raise cost allocation difficulties, and provide opportunities for joint activity abusing the relationship between the two affiliates. 37/

2. **NetCo would not engage in any retail marketing.** NetCo would shed its role as a retail company and focus on its task of providing wholesale network facilities to competing retail providers. This would provide the RBOC with the necessary incentives to make ServeCo a successful retail company.

3. **ServeCo would deal with NetCo only on an *equal* (not "separate but equal") basis with other CLECs.** Parity between the RBOC's provision of local exchange service to itself and to unaffiliated LECs is the cornerstone of the competitive checklist. Yet parity is difficult to achieve when the comparison involves apples and oranges -- the ILEC's self-provision of local exchange service (apples) with its provision of network elements and resale to unaffiliated carriers through a separate, and entirely different, set of operational interfaces (oranges). If the RBOC's retail arm must purchase the same network inputs at the same rates, terms, and conditions as other CLECs, and through the same OSS systems, then those inputs will actually have to work. Parity will be easier to demonstrate (and discrimination will be easier to detect). This principle also requires that when ServeCo purchases local exchange inputs from NetCo, it will do so pursuant to general tariffs, or, if no tariffs exist, under interconnection agreements that are subject to a pick-and-choose requirement.

37/ As previously noted, this provision must also apply to ServeCo's relationship with HoldCo and all other HoldCo affiliates.

4. **Substantial public ownership of ServeCo (approximately 40% or more).** Under any structure short of full divestiture, HoldCo still will have an incentive to maximize its overall corporate interest through its control of NetCo and ServeCo. However, significant public ownership in ServeCo helps create independent fiduciary duties to shareholders other than HoldCo. This increases the likelihood that ServeCo will compete vigorously in the retail market, price its retail offerings to reflect the actual prices of the inputs it obtains from NetCo, and demand the best prices and quality for network inputs from NetCo. Public ownership also creates disclosure requirements that would make it more obvious if HoldCo were to pursue a strategy of operating ServeCo at a loss while the real profits are made in NetCo (through above cost network input rates to all carriers, for example). Finally, public ownership reduces the return to HoldCo from NetCo misconduct that benefits ServeCo.

5. **Independent directors on the ServeCo board, including representatives of the non-HoldCo shareholders.** Independent directors also will increase the likelihood that ServeCo will act in its own best interests, independent of NetCo and HoldCo. Independent members representing the public shareholders also would serve as "watchdogs" on possible board efforts to put HoldCo interests ahead of ServeCo's independent best interest.

6. **Compensation for ServeCo management based only on ServeCo performance, not performance of HoldCo or NetCo.** Compensation, including bonuses and stock options, that are tied to the performance of ServeCo itself should reduce the incentives of ServeCo management to consider the interests of NetCo in their business plans. Instead, they should demand from NetCo low prices, high network quality, and good service, including access to the most efficient and viable means of providing local exchange service (for example, combined network elements). Broader public benefits then follow because, as noted above, if NetCo provides these efficient inputs to ServeCo, it must also provide them to all other retail service providers.

7. **<u>As a key transitional matter, ServeCo would not provide service to a NetCo customer</u>.** The retail affiliate (which is also the sole interLATA affiliate of the RBOC) must be required to win the local customer from NetCo before it is allowed to provide interLATA service to that customer. Without this requirement, the RBOC could simply provide interLATA service on a "side-by-side" basis to its existing local exchange customer base without switching a single customer's local service. In these circumstances, the RBOC has little incentive to provide non-discriminatory access to the inputs that non-affiliated CLECs need to provide local service. The conflicts of interest are not really broken. Once a retail local service customer has left NetCo, for example to go to a CLEC other than ServeCo, then ServeCo can be allowed to sell stand-alone interLATA services to such a customer. Once NetCo's operations systems supporting network elements have been shown to be equivalent to the PIC systems used to change long distance carriers, a state commission may then order balloting and allocation to eliminate NetCo's remaining embedded base, and this feature of the plan would expire.

The "seven minimums" LCI identifies are interrelated; each of them must be present to have an acceptable "Fast Track" plan. Again, LCI is not asking the Commission to *require* structural separation on these terms. And again, states are free to take additional steps beyond the "seven minimums" to reflect their own conditions and statutes, in full accord with their traditional jurisdiction. Thus, the plan in no way alters or affects the jurisdiction of individual PSCs to determine what measures are necessary and desirable to protect local competition and telephone consumers in their state.

But if the "seven minimums" are adopted, we believe that the current stalemate will be broken, consumers (especially residential consumers) can enjoy the benefits of the Act -- and the Commission and the states therefore promptly can grant an RBOC both interLATA entry and unregulated retail pricing. 38/ This can be seen in the context of the three barriers to local competition discussed above.

B. Addressing RBOC Conflicts of Interest Will Promote Local Competition.

1. Resolution of the OSS Barrier.

Under the "Fast Track" proposal, the RBOC finally will have a direct incentive to design OSS systems of the highest quality possible, as rapidly as possible, because it will have to live with those same systems. In addition, because NetCo must deal with ServeCo as if it were an entirely unaffiliated CLEC, NetCo will be required to create and manage OSS systems and related "customer care" functions that facilitate the retail services of *all* service providers. 39/ Those systems will function with a single OSS interface used by NetCo to provision ServeCo and *all other CLECs*. NetCo similarly will be required to give equal treatment to its ServeCo affiliate and other CLECs in such matters as maintenance and customer support. Because the same systems will have to be made available to all CLECs, opportunities to detect discrimination will be greater, reducing the complexity of other Section 251 issues, both pre- and post-Section 271 RBOC entry.

2. Resolution of the UNE Barrier.

Under the "Fast Track" plan RBOCs also finally will have an incentive to make available the UNEs needed to provide local service, in the forms needed by competing service providers. Now ServeCo will require UNEs itself, and will have to go to NetCo to get them. In turn, NetCo

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38/ This assumes that the "seven minimums" of the NetCo/ServeCo structure are maintained and enforceable under Section 271(d) on a going forward basis after interLATA entry, subject to the plan's sunset provision. The RBOC would have to agree to this condition.

39/ The Commission already has held that any RBOC interLATA affiliate must use the same OSS system or "gateway" as unaffiliated CLECs use when ordering local exchange inputs. *Non-Accounting Safeguards Order*, 11 FCC Rcd at 22058, para. 316.

will be required to make UNEs available to all parties on the same terms and conditions. Unlawful discrimination, if any, should be easier to identify and remedy if it occurs.

LCI believes that this structural approach will have its greatest benefit by bringing competition to residential customers. Mass-market applications such as residential competition require quick, cost-effective and reliable access to network elements. If ServeCo is held to the same ordering and provisions systems as all CLECs, then NetCo will be forced to develop systems which support competition in this sector. Thus, one of the principle advantages of the LCI plan will be widespread local competition to all customer classes, including residential customers.

In short, LCI expects that under its plan RBOC conflicts of interest will be sufficiently reduced to make it much more likely that NetCo will provide UNEs in the form in the form necessary to permit broad-scale local competition to proceed, and do so on efficient terms. In particular, it will be much easier for the Commission to monitor the market, identify any UNE discrimination, and take prompt corrective action. 40/

3. Resolution of the Pricing Barrier.

Finally, the LCI "Fast Track" proposal would reduce the competitive risk of unlawful price discrimination. Under the LCI plan ServeCo would see NetCo's charges as real costs -- just like its rivals. ServeCo therefore should have no cost advantage when obtaining UNEs,

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40/ This is not to say that incentives to discriminate with respect to UNEs are eliminated by the LCI plan. Particularly during the early period while NetCo retains the majority of the retail base, HoldCo still will have a strong incentive to discourage use of UNEs. This is because the longer that NetCo retains that base, the longer HoldCo will keep control of the substantial access and other revenues associated with its current retail customers. It would be highly suspicious if ServeCo predominantly offered local service on a Section 251(c)(4) resale basis rather than by making use of UNEs the way that its competitors plan to do. This would suggest that, notwithstanding attempts to make ServeCo independent, HoldCo is still able to profit-maximize by blocking UNE-based competition by retail service providers. This problem will bear watching in the short term. It is why one important element of the "Fast Track" plan is a commitment by the RBOC that NetCo will cooperate in the provision of UNEs in both a combined and uncombined form.

exchange access to embedded base NetCo customers, support activities such as order processing, billing, and maintenance service, or any other wholesale input.

The "Fast Track" plan admittedly has more limited value as a device to encourage NetCo to reduce its rates to economic cost. Over time market forces may help drive down NetCo rates as retail companies -- including ServeCo itself -- have other network alternatives. It is also expected that ServeCo's non-HoldCo shareholders will exert influence on ServeCo to push NetCo to reduce rates even in the absence of competitive alternatives. However, LCI recognizes that any such pressures will be met by countervailing HoldCo pressures to maximize NetCo revenues for the overall benefit of HoldCo. Therefore, the FCC and state commissions still will need to oversee NetCo's pricing so long as it continues to hold a dominant position in the market for local exchange facilities. As noted above, it remains critical that NetCo comply with the cost-based pricing requirements of the Act. 41/

With that important caveat, local competition can proceed so long as NetCo is strictly prohibited from favoring ServeCo in its pricing (such as through volume or other discounts that only ServeCo can qualify for), and so long as its incentives to do so are mitigated by all the separation requirements discussed above. These plan components, coupled with effective state pricing oversight of NetCo, can permit the FCC to grant a rebuttable presumption of 271 compliance for state-approved prices. Importantly, then, the current stalemate can be broken.

41/ LCI also recognizes that regulation of NetCo will continue to be necessary to prevent it from blocking the development of competing facilities networks that may eventually erode NetCo's dominance. For example, NetCo still will have incentives to deny reasonable interconnection to other network facilities, whether those of ServeCo or another CLEC. However, the "Fast Track" proposal does nothing to increase this concern, and the inevitable introduction of new facilities by ServeCo should bring beneficial incentives to interconnection in the same way we expect our plan to accelerate retail competition.

Overall, "Fast Track" (i) insulates retail competition from the consequences of excessive NetCo pricing so that it can proceed with minimal regulation, (ii) makes it easier for regulators to identify any anti-competitive conduct by NetCo; and (iii) allows limited regulatory resources to be focused on creating facilities competition that eventually will allow "fast track"-style separation to sunset.

C. The Electric Utility Industry Analogy

The practical soundness of LCI's proposal is confirmed by significant experience across the nation in other industries. For example, in pursuing restructuring in the electric area (where, as with telephony, the facilities involved in transmission and distribution must be shared by competitors in retail services), state commissions have been motivated by similar concerns with discrimination and lack of competitive choice at the retail level.

Illustratively, in ordering that all electric utilities turn over their control of transmission facilities to an independent entity (the independent system operator or ISO), the California PUC observed, in terms equally applicable here:

> The establishment of an ISO lessens the potential for owners of the transmission system to favor their own generation facilities over non-utility facilities in providing transmission access. Coupled with FERC's principles of open, nondiscriminatory transmission access, disaggregation of the transmission function will enhance fair competition among generators. 42/

The California Commission recognized that this structure would generate the "operational efficiency inherent in a transmission network which has no economic interest other than fostering open access and the facilitation of supply from generators irrespective of their ownership." 43/

Likewise in Massachusetts, the Department of Public Utilities concluded that, to minimize the potential for vertical market power abuse by electric utilities, electric companies must functionally separate generation, distribution, and transmission functions, and form separate

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42/ *Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation*, California Public Utilities Commission, R. 94-04-031, I.94-04-032, Decision 95-12-063, (Dec. 20, 1995), as modified by D.96-01-099, (Jan. 10, 1996), 166 PUR 4th at 18 (also ordering entities selling electric energy to pool their power for sale to others, including "marketers" that sell the power to retail customers) ("*California Proposed Policies*").

43/ *California Proposed Policies,* 166 PUR 4th at 18-19 (also noting that this structure would create other lasting benefits, including reduction of disputes, cost savings, and a nondiscriminatory pricing system for use of the common network facilities).

corporate marketing affiliates for all sales of electric power if they retain generation assets. As the Department explained, again in terms applicable here: "[T]hose electric companies that have enjoyed a monopoly position cannot be expected to forgo willingly the advantages that monopoly status afforded them in the past. 44/ The Department concluded that the functional separation of generation from transmission and distribution services was a necessary first step to curb an electric company's ability to provide itself an undue advantage in buying or selling services in competitive markets.

The LCI "Fast Track" proposal builds on these same principles. We recognize that others have suggested that the electric industry model may have lessons for creating local telephone competition. This Commission should take the steps necessary to implement just such a retail/wholesale structure for RBOCs interested in helping break the current stalemate.

IV. LEGAL AUTHORITY FOR THE PROPOSAL.

The Commission has clear authority under the Communications Act to adopt the declaratory rulings requested here, and thereby clear the path for any RBOC that wants to adopt the "Fast Track" approach. As noted above, LCI is not proposing any change in the substantive requirements of the Act. RBOCs still must comply with Sections 271 and 272 before entering the interLATA market. Section 251 still applies, including the safeguards of Section 251(h) that prevent an ILEC from evading its responsibilities by creating new affiliates. The RBOCs still will be subject to Sections 201 and 202 and other sections of the Act.

In essence, all that "Fast Track" does is create a kind of safe harbor for the RBOCs. The stalemate here is at bottom a question of what are the facts: Have the RBOCs met the essential prerequisites for local competition (the competitive checklist)? Is it in the public interest for them to enter the interLATA market? Is an RBOC evading its Section 251(c) responsibilities by

44/ *Electric Industry Restructuring Plan: Model Rules and Legislative Proposal*, Massachusetts D.P.U., D.P.U. 96-100, at 66 (Dec. 30, 1996).

acting through an affiliate or successor? Does the RBOC have market power in a given circumstance such that it must be found a dominant carrier?

The "Fast Track" plan cuts through all of this debate. The Commission would be declaring that -- if the RBOC meets all of the "seven minimums" discussed above -- these factual questions can be resolved quickly in their favor. The Commission does not need to, and should not, take a position on how it might answer these questions on different facts. 45/

LCI submits that establishment of this kind of safe harbor would productively focus on and address the root problem of RBOC conflicts of interest in a comprehensive, integrated fashion. Significantly, RBOCs would in no way be required to take advantage of the safe harbor. They could continue to pursue today's path, and their factual cases would be evaluated under the current regime. 46/ Clearly, however, the Commission has in the past (and would need in the future) to test those facts much more rigorously if the incentives and opportunities to discriminate against competitors are not checked through the "seven minimum" safeguards proposed here.

The "Fast Track" Plan is fully consistent with tools the Commission has used in the past to control anti-competitive conduct. The Commission "has traditionally used its general

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45/ In an important sense, the LCI plan builds on a concept reflected in the Commission's recent *Order* addressing BellSouth's Section 271 application for South Carolina. There the Commission established a "safe harbor" regarding inbound telemarketing scripts to provide guidance to the RBOCs on this narrow but important question. The Commission found that scripts such as the one proposed by BellSouth were acceptable, but made clear that other scripts might or might not be lawful depending upon the facts. *See Application of BellSouth Corp. Pursuant to Section 271*, CC Docket No. 97-208, FCC 97-418, *supra*, at para. 236.

46/ Those facts, of course, will be influenced by how states require RBOCs to structure their operations. For example, the "Fast Track" plan does not conflict with any authority a state may have to mandate retail/wholesale separation (including separation going further than proposed here) pursuant to its own statutes, and its own review of local market conditions. This Petition only asks the Commission to adopt declaratory rulings to establish a safe harbor, a harbor that the RBOC may enter either voluntarily or pursuant to state direction.

authority under the Communications Act to impose separate affiliate requirements" 47/, and has confirmed its authority to do so since passage of the 1996 Act. 48/

Illustratively, in *Computer II* (which prefigures the Act's Section 272 subsidiary requirements in certain respects), the Commission used its general rulemaking authority to require AT&T (i.e., the integrated Bell system) to offer enhanced services and customer premises equipment through subsidiaries that were separated fully from its telecommunications affiliates. 49/ Similarly, the Commission imposed separate affiliate requirements on independent

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47/ *Amendment of the Commission's Rules to Establish Competitive Service Safeguards for Local Exchange Carrier Provision of Commercial Mobile Radio Services, Implementation of Section 601(d) of the Telecommunications Act of 1996*, Report and Order, WT Docket No. 96-162, FCC 97-352, at para. 47 (rel. Oct. 3, 1997) ("*CMRS Competitive Safeguards Order*"), *citing Regulatory & Policy Problems Presented by the Interdependence of Computer & Communications Service and Facilities*, 28 FCC 2d 291 (1970) (*Tentative Decision)* (Requiring common carriers to furnish data processing services only through separate corporate entities meeting certain separation requirements). *Policy and Rules Concerning the Furnishing of Customer Premises Equipment, Enhanced Services and Cellular Communications Services by the Bell Operating Companies*, 95 FCC 2d 1117 (1983) ("*BOC Separation Order*"), *aff'd sub nom. Illinois Bell Tel. Co. v. FCC*, 740 F.2d 465, 467 (7th Cir. 1984) (forbidding the BOCs from offering enhanced services and customer premises equipment other than through separate subsidiaries); *Regulatory and Policy Problems Presented by the Interdependence of Computer and Communication Services and Facilities* 28 FCC 2d 267 (1971) ("*Computer I*"), *aff'd in part sub nom GTE Serv. Corp. v. FCC*, 474 F.2d 724 (2d Cir. 1973).

48/ See, *e.g.*, *Rules and Policies on Foreign Participation in the U.S. Telecommunications Market, Market Energy and Regulation of Foreign-Affiliated Entities*, Report and Order and Order on Reconsideration, IB Docket Nos. 97-142, 95-22, FCC 97-398, at paras. 253-55 (rel. Nov. 26, 1997) ("*Foreign Carrier Protection Order*") (discussing various instances in which the FCC has imposed structural separation requirements on common carriers, and imposing structural separation requirements on U.S. international carriers and their foreign carrier affiliates that possess market power); *Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services*, Report and Order, 11 FCC Rcd 18564, 18579, paras. 29, 30 (1996) ("*BOC Out-of-Region Provision Order*") (offering RBOCs the choice of providing out-of-region, interstate, interexchange services under non-dominant regulation if the RBOCs offer those services through a separate affiliate meeting certain separation requirements, and rejecting arguments that Section 272(a)(2) prohibits the FCC from doing so).

49/ *Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry)*, Final Decision, 77 FCC 2d 384, 486-87 (1980) ("*Computer II*"), *recon.*, 84

ILECs in connection with their provision of in-region interexchange services, and re-affirmed those requirements after the 1996 Act was passed. 50/ The Commission also has imposed separate affiliate requirements on the LECs' in-region provision of commercial mobile radio services (CMRS), relying on its general rulemaking authority (and no specific statutory provision). 51/ And the Commission recently adopted a requirement that U.S. international carriers regulated as dominant and affiliated with foreign carriers must provide service in the U.S. market through a corporation separate from the foreign carrier affiliate. 52/

The Commission's plenary authority to adopt structural approaches to regulatory problems derives from the Act itself, specifically, from the FCC's statutory power to "make such rules and regulations, and issue such orders, not inconsistent with this Act, as may be necessary

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FCC 2d 50 (1980), *aff'd sub nom. Computer & Communications Indus. Ass'n v. FCC*, 693 F.2d 198, 218-19 (1982) ("*CCIA*"), *cert. denied*, 461 U.S. 938 (1983).

50/ *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area*, Second Report and Order and Third Report and Order, CC Docket Nos. 96-149, 96-61, FCC 97-142 (rel. Apr. 18, 1997), at para. 173 ("*Regulatory Treatment Order*").

51/ *CMRS Competitive Safeguards Order, supra,* at paras. 4, 47 (requiring ILECs to provide in-region commercial mobile radio service through a structurally separate corporation meeting certain separation requirements, and rejecting arguments that Section 272(a) limits the FCC's authority to impose such requirements).

52/ *Foreign Carrier Participation Order* at para. 257. The Commission's authority to create a regulatory framework specific to a particular corporate structure is not circumscribed by Section 272. Section 272(f)(3) states that "[n]othing in this subsection shall be construed to limit the authority of the Commission under any other section of this Act to prescribe safeguards consistent with the public interest, convenience, and necessity." As the Commission has explained, "Section 272(f)(3) states that [the FCC] maintain[s] authority to impose safeguards under other sections of the Act." *CMRS Competitive Safeguards Order* at para. 47. Section 601(c)(3) of the Act likewise provides that "the amendments made by this Act shall not be construed to modify, impair, or supersede Federal .... law unless expressly so provided." Thus, while Section 272 prescribes certain requirements concerning affiliates, it does not preclude the Commission from going beyond its minimal terms or from allowing for separate affiliate and related requirements for services and entities other than those listed in that provision. *CMRS Competitive Safeguards Order* at para. 47; *BOC Out-of-Region Provision Order,* 11 FCC Rcd at 18579; *Regulatory Treatment Order* at para. 168.

in the execution of its functions," and to "prescribe such rules and regulations as may be necessary to carry out the provisions of this Act." 53/

All that said, it is important not to lose sight of the central difference between the Commission's actions in these orders, and the declaratory rulings requested here. There the FCC affirmatively mandated private conduct, while under "Fast Track" the FCC is clearing a path without ordering participation. RBOCs can still obtain interLATA authorizations without the presumption contemplated here. In that case, however, the RBOCs' inherent conflicts of interest are likely to make the Section 271 process slower and more complex, and the RBOCs inevitably will have to face more stringent regulation post-entry. LCI hopes the RBOCs will choose the "Fast Track" path. But that is a decision they can make for themselves.

The "Fast Track" option is akin to other recent Commission decisions regarding ILEC regulation. For example, the Commission has allowed ILECs to provide in-region broadband CMRS so long as they do so through a separate CMRS affiliate. 54/ The Commission reached a similar conclusion with respect to RBOC out-of-region interLATA activities, when it stated:

> This order, in effect, offers the BOCs a *choice* of providing out-of-region, interstate interexchange services under dominant regulation if they wish to furnish those services directly or under non-dominant regulation if they wish to offer those services through a separate affiliate that meets the separation requirements. 55/

In sum, there is nothing novel about an agency, including the Commission, determining under its rulemaking and regulatory authority that structural separation requirements are

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53/ 47 U.S.C. §§ 154(i), 201(b), respectively; see also 47 U.S.C. § 254(k).

54/ *CMRS Competitive Safeguards Order* at para. 4.

55/ *BOC Out-of-Region Provision Order*, 11 FCC Rcd at 18579, para. 30; *see also Regulatory Treatment Order* at para. 173; *Competitive Carrier Order,* 98 FCC 2d at 1198 (FCC established that it would regulate as non-dominant the provision of domestic, interstate, interexchange services by local exchange carriers if those services were provided through separate affiliates satisfying certain separation requirements).

reasonable means to carry out the intent of a statute to enhance competition. This petition seeks far milder steps that are squarely within the scope of the Commission's authority.

V. OVERALL BENEFITS OF THE "FAST TRACK" PLAN.

The proposal promises numerous benefits for all concerned, including consumers, RBOCs, CLECs, this Commission and the states. We have discussed these benefits in the context of the three barriers of OSS, UNEs and pricing. But stepping back, the overall benefits of "Fast Track" are compelling:

A. Faster Advent of Local Competition, Especially Residential Choice.

The proposal could be adopted and implemented quickly, with open, residential retail competition beginning by the end of 1998. Doing so promises to allow for a far quicker opening of local telephone markets than otherwise likely will occur, as well as entry of the RBOCs into the long distance market more quickly.

In particular, "Fast Track" will establish retail competition in the residential market, where the RBOC's dominant network position is today most complete, and where it is otherwise likely to continue for the foreseeable future.

B. Simplification of Section 271 Compliance.

The proposal provides a far simpler and faster way for any RBOC to meet Section 271. It also would make the Commission's Section 271 review work simpler, and should eliminate much of the dispute now taking place in Section 271 proceedings. This is not a trivial matter. LCI believes its proposal will streamline the 271 process as the RBOC incentives shift from *demonstrating* theoretical or nominal compliance to *achieving* actual compliance, for the benefit of ServeCo -- and all other CLECs.

C. Reduced Need for Regulation With Enhanced Post-Entry Competition.

The RBOC conflicts of interest discussed in this petition not only delay retail competition, they also require significant regulatory intervention. Some of that can be seen in the initial involvement of federal and state officials in complex technical questions regarding how the local network can be opened up in the first place. But even after interLATA entry occurs, ongoing regulation will be necessary to check the continuing incentives of the RBOCs to favor their own retail services. Such regulation will be difficult, costly, and burdensome. Adoption of LCI's "Fast Track" proposal would not eliminate the need for all such regulation and supervision, but it would reduce it substantially because the new corporate structure would reduce both the incentives and the ability of NetCo to discriminate.

Importantly, while many difficult regulatory problems would be simplified under "Fast Track", none would become more difficult. States and the FCC still will face questions regarding such matters as the costing of network facilities, recovery of RBOC historical costs, the appropriate level of universal service support, and network quality and reliability. But in each case, separation of the RBOC's retail services in this fashion allows regulatory attention to focus on NetCo, the remaining dominant firm. The retail market can be substantially deregulated.

In short, the proposal would provide ongoing assurance after interLATA entry that, under the Department of Justice's test, the process of opening the local telephone markets to competition is in fact "irreversible" because the new incentive structure for the BOCs will promote ongoing compliance with the Act. 56/

D. Promotion of Universal Service.

The "Fast Track" Plan also simplifies the process of protecting universal service goals. First of all, the plan is consistent with current universal service rules. To the extent that NetCo continues to serve the embedded retail customer base of the RBOC, it will qualify for universal service in appropriate circumstances. Similarly, ServeCo will be eligible for universal service on the same basis as other CLECs.

56/ *See* DOJ Ameritech Michigan Evaluation at 3.

But beyond that, the process of promoting universal service should become easier under the plan. As a threshold observation, the first key to achieving universal service is achieving universal competition. In an environment of robust competition for residential customers, the principle concern of universal service (that rates will be unaffordable) is lessened. Competition by definition should exert downward pricing pressure. Second, once NetCo is out of the retail market all together, it will be compensated directly and fully for the cost of its wholesale inputs and service activity. It will not receive universal service, nor will it pay universal service contribution because it will not be serving end users. NetCo pricing issues thus will not need to be complicated by this issue, and can focus only on ensuring recovery of NetCo's actual costs.

The universal service policy issue will then focus entirely where Section 254 intended: on how much revenue is needed to meet universal service goals, and how to ensure that this revenue is distributed on a competitively neutral basis to ServeCo and all other firms providing retail services qualifying for support. Regulators will have a much easier time addressing these issues -- and ensuring the competitively neutral administration required by the Act -- under the Fast Track Plan.

E. Enhanced Maintenance of Network Quality and Reliability.

"Fast Track" will give NetCo strong incentives to maintain network quality and reliability because over time it will have as its sole focus its carrier's-carrier function, with an unmixed incentive to make it as feasible and efficient as possible to use its wholesale facilities and operation systems. To the extent price increases are necessary to pay for such enhancements, the state commissions can assess and perform this function just as they do now—but in far less contentious circumstances. Over time the arrival of competing networks should reduce the need for regulation in this area.

At the same time, it is significant that "Fast Track" in no way restricts the ability of ServeCo to build its own facilities (as opposed to have facilities assigned to it at separation). Once ServeCo is properly established, it may build whatever facilities it wants free from the obligations of Section 251(c) to make those facilities available to other carriers. Thus, the plan responds to complaints by some RBOCs -- unjustified in LCI's view -- that the current structure deters investment and innovation.

F. AIN.

The proposed NetCo/ServeCo structure also would produce benefits in connection with the Advanced Intelligent Network (AIN). NetCo would have improved incentives to provide open access to AIN components, such as the Service Control Point, Service Creation Environment, and Service Management System, in order to meet the needs of carrier customers. NetCo would have more incentive to ensure that the interfaces to each system were well documented and easy to use, and to provide for fully automated provisioning. If, on the other hand, NetCo were to require competitors to access the signaling network (and hence switch triggers) via a mediation point, then ServeCo would be required to do so as well. Thus, network reliability issues and competitive equality will be addressed because ServeCo and its CLEC competitors will be on an equal footing as regards NetCo's AIN. "Fast Track" is likely to accelerate deployment of enhanced AIN services by all service providers, with huge benefits for American consumers. But at a minimum, the RBOCs at least could no longer discriminate against competitors regarding access to AIN capabilities.

VI. THE ROLE OF STATE COMMISSIONS.

LCI fully recognizes the central responsibility of state commissions to regulate local markets. The state commissions bear front line responsibility for ensuring that every American enjoys the benefits of local telecommunications competition. InterLATA entry also will be a watershed event for the states, presenting new issues and challenges.

"Fast Track" responds to these intrastate developments and recognizes the key role and unique perspective of the states. That is why LCI is filing related petitions with both the Illinois

Commerce Commission and the New York Public Service Commission, and welcomes consideration from other states.

The ICC and NYPSC petitions will ask those Commissions to open proceedings: (a) to consider the intrastate actions necessary to implement "Fast Track," and (b) to investigate more generally how RBOC interLATA entry will impact, and necessitate modification of, each state commission's existing regulatory requirements. LCI is filing in these two states because they were among the first to begin efforts to create local competition nearly a decade ago. Thus, the importance of eliminating the continuing barriers, so that competition can extend broadly to residential and small business customers, is most apparent in these states with their long history of attempting to open the market. The NYPSC also has the benefit of its experience with the separation of Rochester Telephone. LCI recognizes that other states have been very active in trying to foster local competition as well. "Fast Track" is designed to work throughout the nation.

If the RBOCs are to enter the interLATA market, states will obviously need to consider how that entry may require revision of existing regulations. This is true however RBOCs structure their business operations. However, LCI submits that its "Fast Track" plan is directly relevant to such inquiries into post-271 intrastate regulation. If RBOCs adopt the structural separation proposed here (and such other measures as a particular state commission might deem necessary) then it would be appropriate for states to grant ServeCo substantial flexibility in the pricing of its retail services -- flexibility equivalent to that afforded to other CLECs. Conversely, however, if the interests of the RBOC wholesale and retail operations remain intermixed, then interLATA entry will need to be accompanied by new regulatory oversight to make sure that the RBOC does not discriminate in favor of itself with respect to exchange access, UNEs and other wholesale inputs. Bundled pricing of retail services (combining local, toll, and other services) will make it more difficult to detect cross-subsidization and to enforce imputation requirements, for example.

In short, "Fast Track" in no way alters or amends existing state authority and jurisdiction. State commissions would have to approve any restructuring plans, adjusting details if necessary to fit their unique statutory authority, established practices, and local conditions. 57/ Specific state actions would include: (i) modifying today's price-cap/incentive regulatory plans to reflect the separation of the RBOC's wholesale/retail roles and the reduced regulation of ServeCo's retail offerings; (ii) adopting transitional requirements to ensure that basic local service will continue to be available under the terms of existing price-cap/incentive mechanisms; and (iii) verification, with the FCC, that the prerequisites of the new structure have been implemented.

Thereafter state commissions would continue to have the primary responsibility for pricing of NetCo's carrier's-carrier (and residual local exchange service) offerings, as well as the intrastate retail and access services provided by ServeCo. 58/ LCI fundamentally expects that less regulation will be needed under its plan because residential customers will be courted by many service providers, not just one. But the bottom line is that the plan does nothing to limit the states' ability to regulate their telecommunications markets -- it only reduces RBOC conflicts of interest so that a state commission's job is made easier, both today and in the post-271 future.

VII. OTHER ISSUES ADDRESSED BY THE PROPOSAL.

A. Protecting the Integrity of the Network.

As noted above, NetCo should have every incentive to continue making investments to preserve its network integrity. TELRIC-based UNE rates should include compensation for this

57/ Of course, the RBOCs still would have to meet the "seven minimums" upon which the proposed declaratory rulings rest in order to qualify for "Fast Track" treatment.

58/ LCI's proposal contemplates that a state commission would substantially eliminate regulation of the prices for ServeCo's retail and exchange access services upon implementation of this plan, but of course the state would retain jurisdiction over these and any competing retail CLEC services as necessary to protect basic service or any other policy.